



Emerging Trends in Transition Fund Strategies

Webinar

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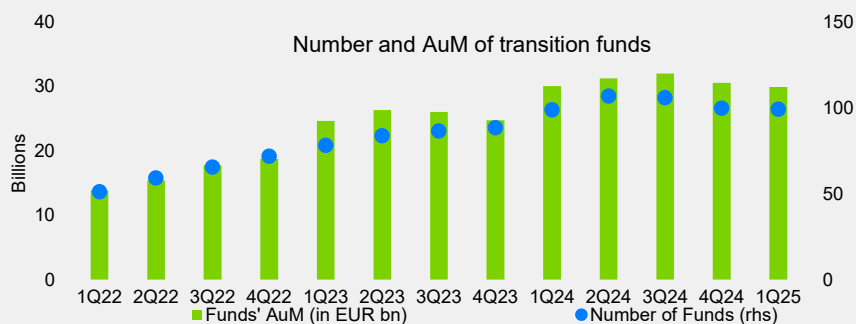
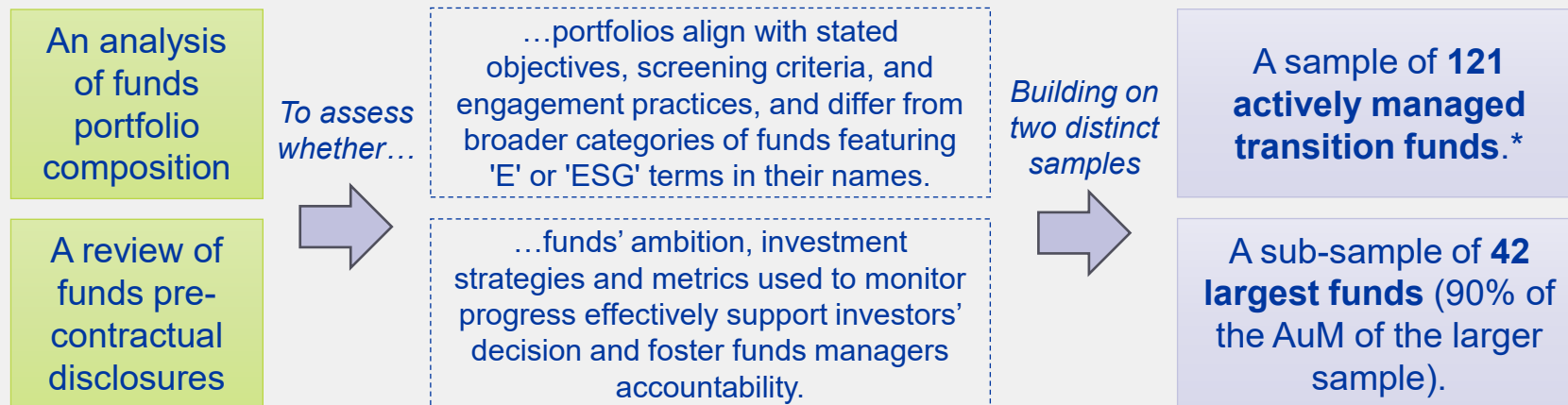
Introduction

- A new investment fund segment emerged to support an economy-wide climate transition and companies transitioning to climate neutrality (“transition funds”).
- Outreach and research suggest that transition funds typically rely on three main levers to deliver climate goals: positive screening, exclusions and engagement.
- The EU regulatory framework provides several tools to transition-minded investors and reflects efforts to standardise practices in this area*. The ESAs have recommended the creation of a transition product category under SFDR.
- **ESMA carried out a fact-finding exercise, with the following objectives:**
 - ➔ To identify emerging patterns in how investment fund managers define and implement transition investment strategies, with a focus on actively-managed funds.
 - ➔ With SFDR expected to be reviewed soon, the work could help inform policy debates and supervisory expectations.

* The 2023 EC Recommendation introduced a definition of transition investments including investments in Taxonomy-aligned economic activities, investments in undertakings or economic activities with a credible transition plan or with a credible science-based targets.
The 2024 ESMA Guidelines on fund names introduced exclusion requirements, applicable to funds with transition-related words in their names consistent with exclusions requirements applicable to EU Climate Benchmarks.

Approach and sample definition

The work covers two complementary workstreams:



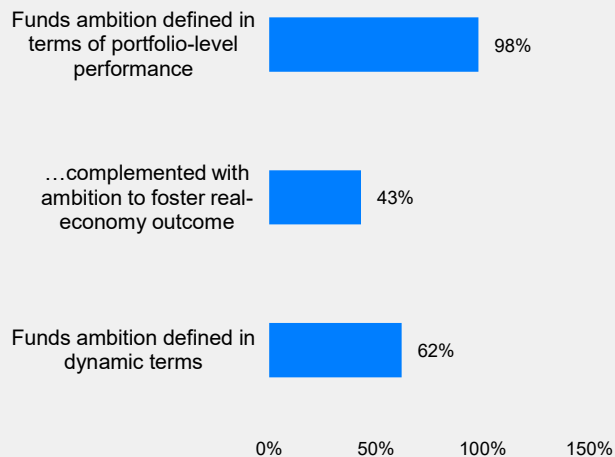
Note: Number of transition funds (RHS) and their AuM (EUR bn). Figures reflect funds with transition-related terms in their names in each quarter; the sample may vary as funds name might change over time.
Sources: ESMA, Morningstar

- **As of March 2025, transition funds collectively managed approximately EUR 30 bn in AuM**
 - About 5% in AuM terms of the broader universe of 1,400 non-index funds using environmental-related words in their name.

* Based on Morningstar data for the period January 2022 to April 2025, covering funds publicly available for sale in the EU.

Transition funds strategies: ambition and target-setting

Key aspects of the funds ambition



Note: This analysis is based on the review of a sub-sample of 42 funds. Ambition of the funds analysed based on pre-contractual disclosures about the sustainability characteristics or objective of the funds.
Sources: ESMA analysis/

- **We first examine how fund managers frame their transition ambition and to what extent the ambition is translated into measurable, time-bound targets:**

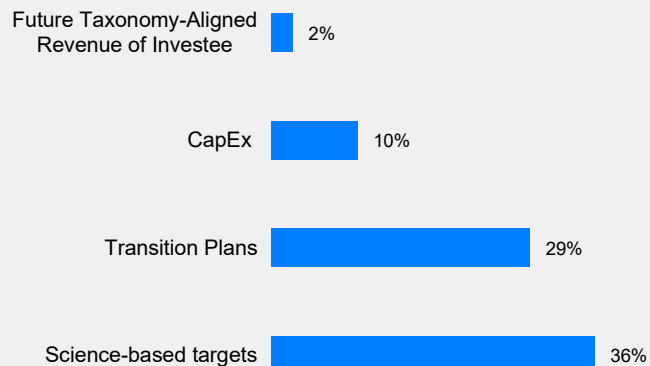
- Transition funds primarily define their ambition at portfolio-level – e.g. carbon intensity of exposure to green activities. This is sometime complemented with an ambition to foster real-economy outcome (43%).*
- Most funds (62%) set their ambition in dynamic terms aiming for a change over time (e.g. reduced financed emissions).
- Most funds (67%) translate their ambition in measurable targets.**
- Focusing on funds with dynamic ambition, most funds (69%) disclose a specific time horizon - ranging from year-on-year trajectories to mid- and long-term targets up to 2050.

* Real-economy outcome refers to measurable changes in environmental or social performance of specific assets (e.g. a reduction in the GHG emissions of an investee company), in contrast to a reduction of financed emissions through the transfer of ownership of carbon-intensive assets.

** 19% of reviewed funds explicitly reference alignment with the 7% year-on-year decarbonisation trajectory mandatory for EU Climate Benchmarks

Transition funds strategies: positive screening and forward-looking data

Forward-looking data for positive screening



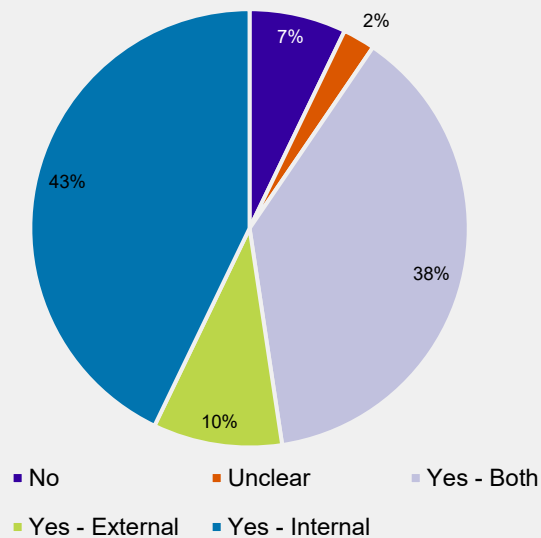
Note: Share of EU transition funds mentioning the use of asset-level forward-looking data in their pre-contractual disclosures, based on a sample of 42 funds as of April 2025. 19% of the funds in the sample refer to more than one of the data points listed above.
Sources: ESMA analysis.

- **64% of funds explicitly mention the use of forward-looking data as criteria for positive screening.***
 - Science-based targets (SBTs) and transition plan as most commonly mentioned. Limited use of CapEx and future Taxonomy-aligned revenue.
 - Asset-level forward-looking data is key to assessing the transition-readiness of investees.
 - This also reflects the adoption of the definition of transition investments provided by the EC Recommendation of 2023.
- **Funds referencing SBTs as part of their investment criteria tend to show higher exposure to companies with validated targets (50% average portfolio share vs 42%).**

* Funds that do not explicitly disclose forward-looking data may rely on ESG ratings that embed such elements (e.g. climate targets, transition plans).

Transition funds strategies: positive screening and the use of ratings

Use of ESG Scores in Transition Fund Strategies



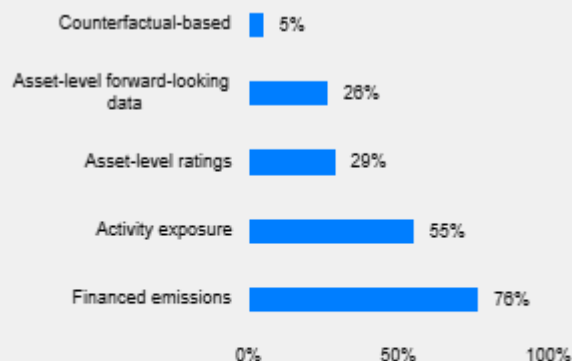
Sources: ESMA analysis

- **The use of ESG ratings or scores for positive screening is widely spread, either developed internally or provided by a third-party: 81% use internal ones, 48% use external ones.**
 - Internal approaches often described in broad qualitative terms. Several refer to NZIF¹ categories but transparency on underlying data and methodology is limited.
 - A small subset of funds mention internal ratings, developed with a view to rate assets' transition readiness in terms of temperature alignment.
 - Where external ratings and scores are mentioned, few funds (18%) disclose the exact products they use². Most commonly disclosed products do not appear to rate transition-readiness³.

1. Net Zero Investment Framework.
2. Based on the pre-contractual documentation.
3. Most products mentioned by fund managers (MSCI ESG Scores, MSCI Environmental Controversy scores, Sustainalytics Risk Ratings) primarily assess a company's exposure to financially material ESG risks and its management of those risks.

Transition funds strategies: metrics used to monitor progress

Metrics used by funds, per category



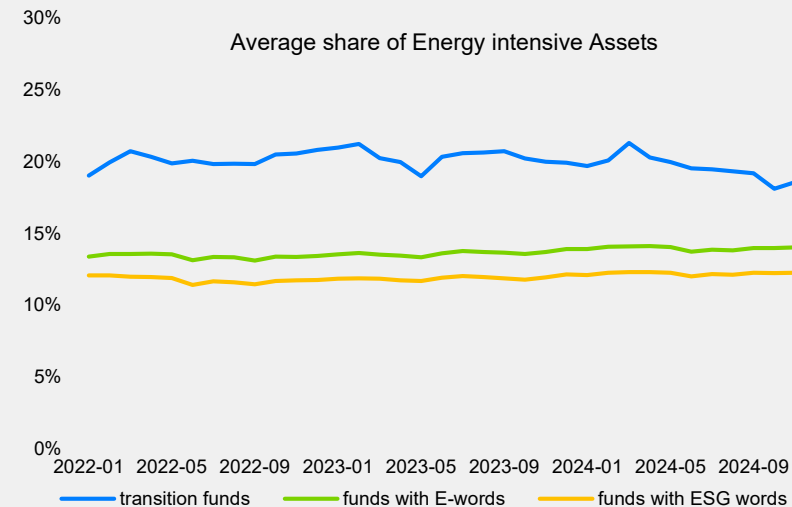
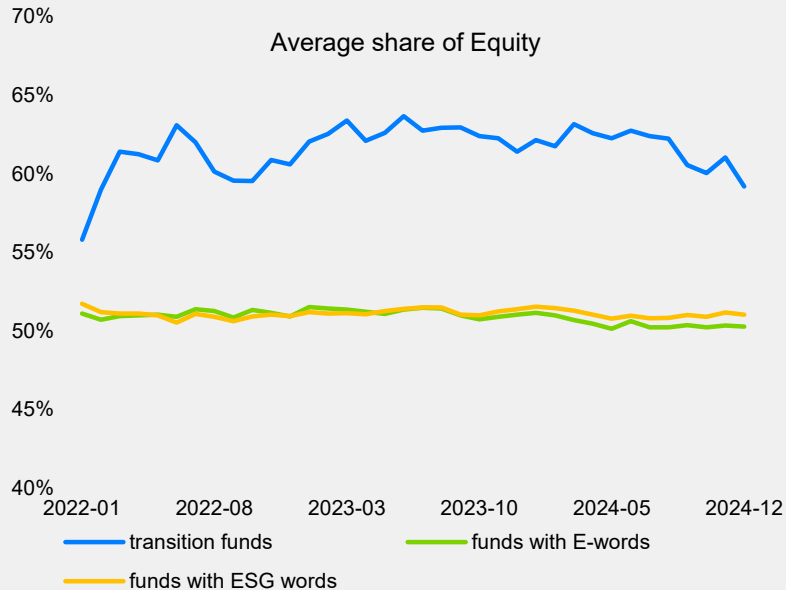
- **Monitoring progress against ambition/targets is key to ensure accountability.** Given the variability in language and metrics used, we created a categorisation to bring consistency and clarity (see table).
- **Most used metrics are about portfolio emissions (76%) and activity-based exposure (55%), both about portfolio-level performance:**
 - The use of metrics related to asset-level ESG ratings and scores (29%) or asset-level forward-looking data (26%) is more limited.
 - But these metrics can inform about investees transition-readiness and the likelihood that real-economy outcomes is achieved.

Note: This analysis is based on the review of a sub-sample of 42 funds. Metric types reflect the underlying indicators used by funds to set targets: portfolio emissions (e.g. GHG emissions or carbon intensity), activities exposure (e.g. green or enabling investments), forward-looking alignment (e.g. science-based targets or CapEx thresholds), ESG ratings-based thresholds (e.g. NZIF categorisation), and counterfactuals (e.g. avoided emissions).

Sources: ESMA

Categories	Illustrative metrics
Financed emissions	Weighted average carbon intensity, absolute GHG emissions.
Activity exposure	Shares of AuM invested in activities classified as green / enabling / transition
Forward-looking data	Share of AuM with SBTs, transition plans, or min level of green CapEx
Asset-level ratings	Share of AuM with minimum transition-readiness scoring (e.g. NZIF category).
Counterfactual-based	Avoided GHG emissions.

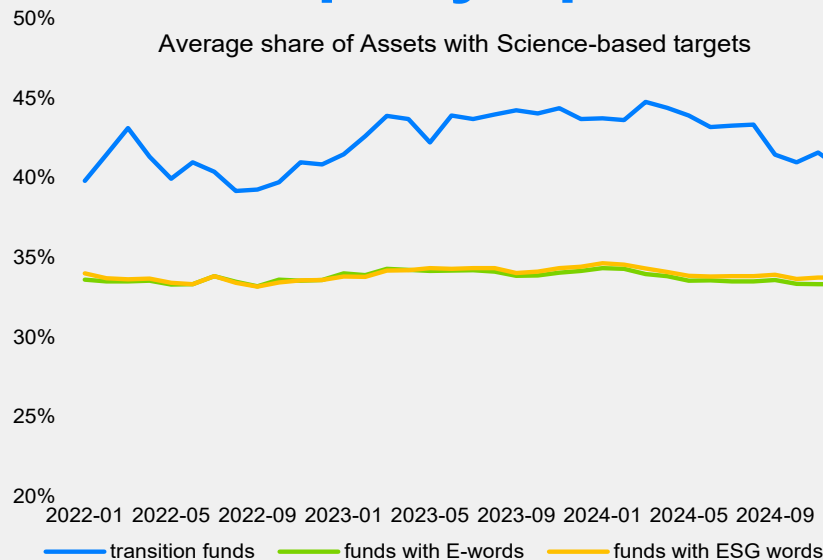
Portfolio composition: Asset allocation



- **Transition funds invest more in equity instruments (60%)** than other E/ESG funds (50%)
 - Equity instruments help finance long-term transformation and enable active ownership and engagement.
 - In contrast, green bond holdings (4%) do not seem to play a major role in transition fund strategies.
- **Transition funds hold a higher share of firms in energy-intensive sectors (17%)** than other E/ESG funds (13%).
 - Investments in transition-enabling sectors aimed at supporting broader decarbonisation
 - Relative focus on hard-to-abate sectors (e.g. industrials) in transition strategies.

Portfolio composition: Company-specific metrics

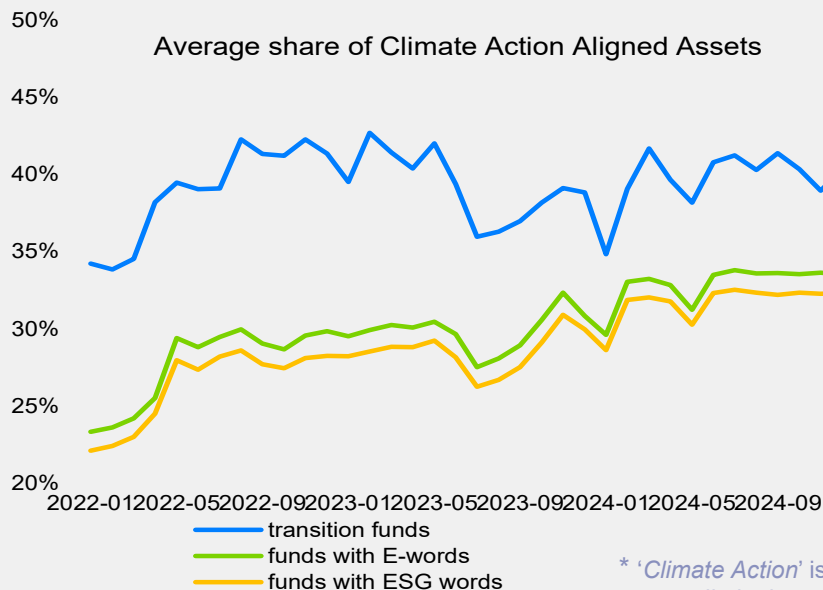
Average share of Assets with Science-based targets



- **Transition funds invest more in firms with science-based targets (41%) compared with E/ESG funds (33%).**

- Use of forward-looking metrics underscores investments in firms that have committed to credible decarbonisation trajectories.
- This is particularly true of funds making explicit reference to science-based targets in their disclosures.

Average share of Climate Action Aligned Assets



- **Transition funds allocate 40% of investments in firms supporting Climate Action* vs. 33% for other E/ESG funds.**

- Some transition strategies focus on climate solutions, even as funds maintain somehow elevated exposure to higher-emitting sectors.

* 'Climate Action' is a Morningstar-defined impact theme which includes measures to promote clean energy, limitations on GHG emissions and climate change adaptation measures. For more details on the underlying calculation methodology, see [here](#).

Regression analysis: Specification

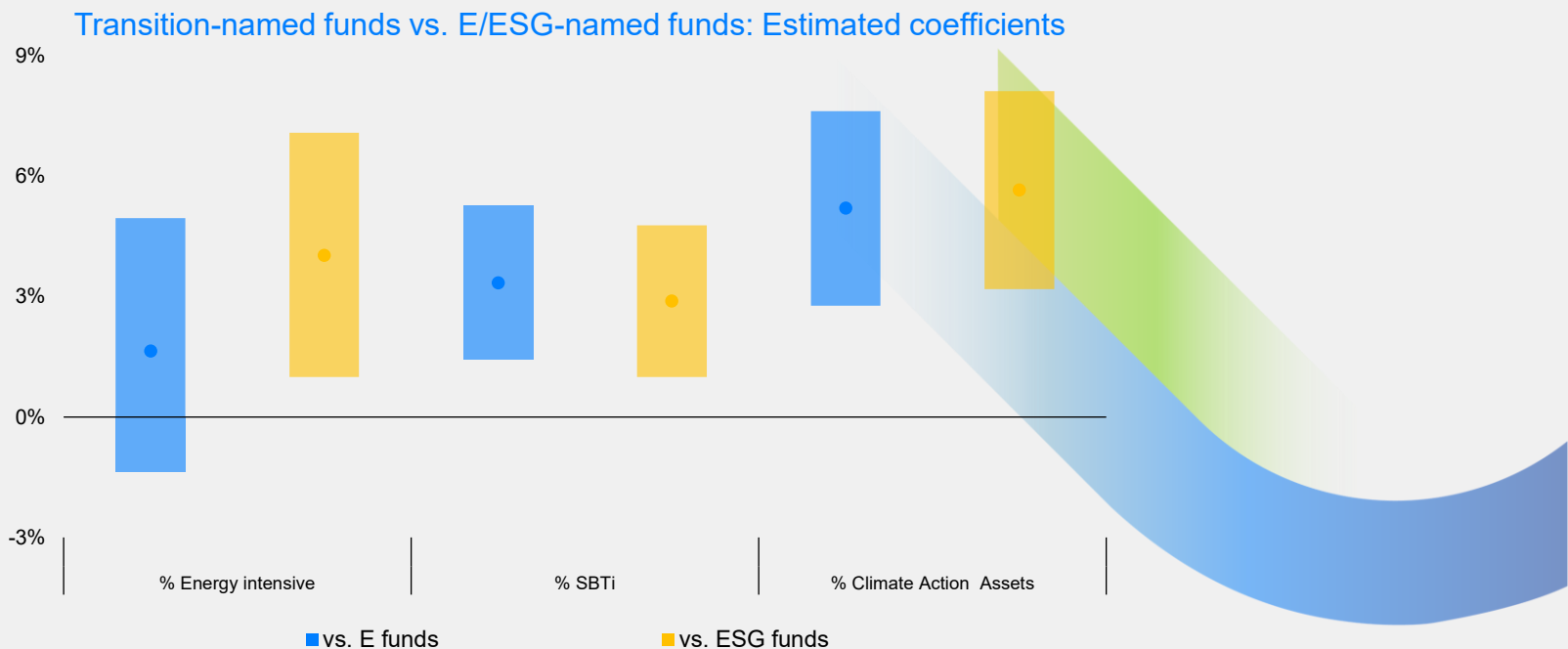
- To test for the statistical significance of these differences, we conduct a panel-data regression based on the following model using monthly portfolio-level data:

$$\%Share_{i,t} = \beta_0 + \beta_1 Transition_i + \sum_n \beta_n Control_{i,t} + \delta_t + \varepsilon_{i,t}$$

- $\%Share_{i,t}$ Share of portfolio investments of fund i at time t
 - $\beta_1 Transition_i$ binary variable for funds using transition words in their name
 - $\beta_n Control_{i,t}$ Vector of controls incl. fund size, net flows, portfolio share of equity, asset class, country of domicile, 12-month returns
 - δ_t Time fixed-effects
- Sample enclosed all funds using ESG- or environmental-related terms in their name

Regression analysis: Results

- The relative differences tend to be smaller when controlling for other relevant factors (e.g. fund size, age, domicile, etc.). While this increases the statistical robustness of the results, some of these factors (such as share of equity or sectorial allocation) are also key features of transition strategies.



Summary of findings

The transition funds segment is still emerging, and practices are evolving. Our main findings include:

1. Transition funds primarily define their ambition in terms of portfolio exposure, which they sometimes complement with an ambition to foster real-economy outcomes. A substantial share of funds also translate their ambition into measurable, time-bound targets.
2. Positive screening of assets is informed by asset-level forward-looking data and generally reflects alignment with the EC definition of transition investments (i.e. taxonomy-aligned CapEx and investments in companies or activities with credible transition plans or SBTs).
3. Positive screening appears to rely on the use of ESG ratings, but the role of these ratings in transition strategies is not always clear, due to limited disclosures by funds managers on the products used or the underlying data and methodologies.
4. To set targets, monitor progress, portfolio emissions and activity exposure metrics are the most used.
5. Data shows that transition funds have distinctive portfolio composition features compared with other environmental and ESG funds. They focus on equity instruments from energy-intensive sectors and show greater exposure to companies with SBTs or involved in climate solutions.
6. These characteristics suggest a more targeted and forward-looking investment approach, consistent with their widespread reliance on engagement.